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Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1996

HANCOCK ELECTRONICS CORPORATION,

Petitioner,

v.

WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF OF RESPONDENT WASHINGTON METROPOLITAN AREA TRANSIT AUTHORITY IN OPPOSITION

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QUESTION PRESENTED

Whether the Court of Appeals correctly held that a government contractor must exercise the contractually specified administrative remedies for breach of its government contract and is thus limited, in any eventual recovery for such breach, to the relief afforded under such administrative remedies?

LISTING OF AFFILIATES PURSUANT TO RULE 29.1

Pursuant to Rule 29.1, Respondent Washington Metropolitan Area Transit Authority ("WMATA") states that it is an agency and instrumentality of Maryland, Virginia and the District of Columbia created by an interstate compact, as authorized by Congress. See, Pub. L. No. 89-774. WMATA operates a regional transportation system in the Washington, DC metropolitan area. As a government entity, WMATA does not have any parent corporation, affiliates or subsidiaries.

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STATEMENT OF THE CASE

Petitioner Hancock Electronics Corporation ("Hancock") entered into a contract with the Washington Metropolitan Area Transit Authority ("WMATA") to design and fabricate braking systems for use on WMATA passenger rail cars. That contract was accurately characterized by the Court of Appeals as a "standard government contract". Pet. App. 4a.[1] A dispute arose between these parties concerning Hancock's obligation to disclose technical materials reflecting the design and operation of the electronic controls for the braking system. Hancock initially agreed to provide these materials and delivered a portion of them. Supp. App. 12. Later, Hancock insisted that the contract did not require delivery of the technical materials, characterized WMATA's requests for those materials a breach of the contract, ceased its performance and sued for expectancy damages in the United States District Court for the Eastern District of Virginia. App. 7-11.

The WMATA/Hancock contract contained provisions, standard in WMATA and federal government contracts, establishing an administrative remedy for disputes. Pet. App. 4a. The District Court granted WMATA's Motion to Dismiss Hancock's Complaint pursuant to Fed. R. Civ. P. Rule 12(b)(6). Pet. App. 12a. WMATA argued that, under the circumstances, Hancock was obliged to

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[1]References to "Pet. App." are to the Appendix to Hancock's Petition For Writ Of Certiorari. References to "Pet." are to the text of that Petition. The Joint Appendix and Supplemental Appendix filed with the Court of Appeals shall be referred to as "App." and "Supp. App.", respectively.

exercise the administrative remedies for redress provided in the parties' contract.

Applying this decades-old principle of government contracts law, the Fourth Circuit Court of Appeals affirmed the District Court's dismissal of Hancock's Complaint. It noted that the contract contained a standard "termination for convenience" clause. Pet. App. 4a. Under established law, any breach of the contract by the government, e.g., by WMATA, would automatically be converted into a termination for convenience by the government. The aggrieved party, e.g., Hancock, would be entitled to the quantum meruit damages specified in the termination for convenience clause, and such damages were to be assessed exclusively by reference to the administrative remedies specified in the contract. Pet. App. 5a.

STATEMENT OF FACTS

The Dispute

WMATA operates the Washington, DC area rapid transit rail system. It contracted with Hancock to design, fabricate and install braking systems for approximately three hundred passenger rail cars. These systems are complex electro-mechanical assemblies. They operate according to intricate electronic programs; e.g., the "brains" of the system, which translate commands from the operator and information from automatic sensing systems into appropriate actions of the mechanical braking components. Supp. App. 10. Because the lives of hundreds of passengers depend directly on the satisfactory performance of these

braking systems under all conceivable circumstances, safety testing of the equipment and its operating systems is an obvious priority for WMATA. This dispute centers around the requirements for safety testing the "brains" of the braking system, the electronic programming.

The electronic "software" governing operation of Hancock's braking systems would be written as a series of instructions in a "high-level" english-like format. Those instructions are then translated into binary-type commands which can received by machines. That translation from "english-like" instructions to binary, machine-readable commands is performed in several steps of greater detail. Supp. App. 11. In order to have an operating system one must compose all these levels of "software". The totality of the "software" composed for the Hancock braking system as well as schematic drawings of the circuitry used to route the instructions generated by that software is referred to as "computer software documentation" by Petitioner. Pet. 3.

Safety testing for computer programming is performed by what is know as a Failure Modes and Effects Analysis ("FMEA") test. In effect, in a FMEA test, the programming is asked to perform in an exhaustive series of conditions simulated on a supercomputer. To be properly performed, FMEA testing requires all levels of the programming to be tested, e.g., from general to specific. WMATA needed to have FMEA tests performed on Hancock's braking system software.

Performance of WMATA's contract with Hancock began in the summer of 1994. From the outset, WMATA

repeatedly told Hancock that the computer software documentation must be provided in order that the FMEA tests be completed in a timely manner. Hancock, orally and in writing, agreed to provide the documentation on many occasions. App. 50-51. In December 1994, Hancock actually delivered a portion of the software documentation to WMATA. Supp. App. 12. The necessary FMEA testing was a highly sophisticated undertaking to be performed by a specialized, third-party, testing firm. Hancock had agreed to deliver the software documentation to a third-party testing firm provided it received substantial, additional compensation for doing so. App. 59-62. WMATA declined to pay the additional demanded compensation, but was willing to negotiate concerning the terms. It directed Hancock to provide the documentation to the testing firm. The relationship deteriorated rapidly from that point.

In April 1994, Hancock representatives arrived in Washington, DC with, according to Hancock's Complaint, the software documentation and schematics, ready to begin qualification testing of their equipment. App. 9. Qualification testing is, essentially, a controlled field test of a complete braking system. It follows a preliminary, factory test of the equipment known as "first article testing". Qualification testing also represents a juncture in performance of the contract when payments to the contractor become due. Hancock refused to provide WMATA with the software documentation and schematics and WMATA refused to permit qualification testing as a consequence.

Litigation

Notwithstanding its many promises to provide the software documentation or its partial delivery of documentation in December 1994, Hancock characterized WMATA's requests to be provided with the remainder of the documentation as "extracontractual demands". On May 11, 1994, Hancock notified WMATA that these extracontractual demands amounted to a breach of contract which excused Hancock from further performance. Hancock filed suit in the District Court on the same day. App. 12. In the succeeding month, WMATA wrote to Hancock twice advising, among other things, that WMATA expected continued performance under the contract. Because performance was not resumed, WMATA notified Hancock that its Contract was being terminated for default on May 15, 1995. Supp. App. 100.

WMATA moved to dismiss the Complaint. The basic thrust of WMATA's arguments was that initial consideration of the parties' dispute was properly vested in the contractually-specified administrative forum, e.g., trial before the U.S. Army Corps of Engineers Board of Contract Appeals. Hancock responded that the nature of the breach of contract allegedly committed by WMATA, e.g., the demand for the remainder of the documentation, constituted a "cardinal change" to the contract and, accordingly, excused Hancock from its contractual duty to exercise its administrative remedies before resort to the District Court.

Argument to the District Court proceeded in two phases. Initially, the Court denied WMATA's motion.

Pet. App. 8a. Subsequently, in response to a motion for reconsideration of that initial decision, the complaint was dismissed. Pet. App. 10a-11a. In these arguments, the parties addressed two main issues. The first, and seminal, question concerned the legal effect of the "Termination for Convenience" clause in the parties' contract. WMATA argued that because the contract contained the termination for convenience clause, any breach of that contract, by WMATA, would, by operation of law, be converted into a termination of the contract for convenience, thereby entitling Hancock to the recovery computed under the termination for convenience provisions of the contract. The recovery permitted Hancock under the termination for convenience provisions of the contract, essentially a quantum meruit reimbursement of expenses and earned profits, could only be assessed under the administrative procedures specified in the Disputes provisions of the contract. If, as WMATA insisted, Hancock's recovery was governed by the law pertaining to the termination for convenience clause, Hancock's sole avenue for redress lay through the Board of Contract Appeals.

The second issue centered around the doctrine of "cardinal change". Hancock argued that WMATA's requests for the software documentation amounted to a "cardinal change" in the terms of its contract. The effect, Hancock insisted, of that cardinal change was to both breach the contract and to entitle Hancock to disregard the administrative remedies specified in the contract. WMATA denied that its actions amounted to a cardinal change in the contract. Moreover, WMATA disagreed with Hancock's suggestion that a "cardinal change" breach of contract constituted a

recognized exception to the settled law that all breaches of contract were to be converted into terminations for convenience in government contracts, like the WMATA/Hancock Contract, which contained termination for convenience clauses.

The District Court held that Hancock's Complaint was properly dismissed because, under the law respecting the constructive termination for convenience doctrine, Hancock's remedies were limited to those available before the Board of Contract Appeals as it implemented the termination for convenience provisions of the Contract. Pet. App. 10a-11a. Rather than filing its case before the Board of Contract Appeals, as the District Court invited it to do, Hancock appealed that decision to the Circuit Court. That Court applied long-established law in the government contracts field and affirmed the District Court. It held:

> Under settled law, whether WMATA breaches or wrongfully terminates a contract, the event is treated as a constructive termination under the Termination for Convenience Clause. See, e.g., General Builders Supply Co. v. United States, 409F. 2f 246,249 (Ct. Cl. 1969). The law thus recognizes that, in entering into a contract, the government limits its potential liability to the value of the performance rendered at the time it terminates the contract for convenience. The combination of the Termination for Convenience, Default, and Dispute Clauses in Hancock's contract with

> WMATA provides, in essence, that upon WMATA's default, Hancock is entitled to its quantum meruit performance under the contract but not its anticipated profits. See generally, C. Nash Jr. & John Cibinic Jr., Federal Procurement Law 1104,1124 (3d ed. 1980). The principle is unique to government contracts and well understood by parties entering into such contracts.

Hancock Electronics Corp. v. WMATA, 81 F. 3d 451,454 (4th Cir. 1996). Pet. App. 4a-5a. There is no good reason to review or to disturb that decision.

ARGUMENT

A. There Is No Conflict Between the Circuit Court's Decision and Decisions By This Court.

Petitioner seeks to create a conflict between the Circuit Court's decision and this Court's holding in College Point Boat Corp. v. United States, 267 U.S. 12 (1925). This is unavailing, for the two decisions are perfectly consistent.

The doctrine of constructive termination for convenience is a proposition of government contracts law which has been developed and applied by the Federal Circuit Court of Appeals beginning in 1963 with its decision in John Reiner & Company v. United States, 325 F. 2d 438 (Ct. Cl. 1963), cert. denied, 377 U.S. 931 (1964). The doctrine, as

developed by the Federal Circuit, holds that any breach or other termination of a contract by the government will entitle the contractor to only those damages available under the contract's termination for convenience clause. It serves an explicit policy. The doctrine operates as a form of liquidated damages agreement under which the government's liability is limited to reimbursement of the contractor's expenses and earned profits but does not extend to expectancy damages. The Federal Circuit was explicit as to this policy in its decision in Nolan Brothers Incorporated v. United States, 405 F. 2d 1250 (Ct. Cl. 1969), where it said:

> This cannot be the result, Plaintiff says, where the government has breached the contract -- it cannot escape the normal common law consequences of its wrongful action by terminating the contract for its own convenience. The answer, we think, is that the convenience article was precisely intended to allow the government to avoid the consequence that it pay unearned profits.

405 F. 2d at 1254 (Citations omitted).

In support of that policy, the courts have held that the constructive termination for convenience doctrine converts any contractor breach claim into a termination for convenience. The circumstances, extent of breach, type of breach or time of breach will not alter that result. The Court of Claims made the sweep of the doctrine perfectly clear in its decision in Kalvar Corporation v. United States, 543 F. 2d 1298, 1304-05 (Ct. Cl. 1976):

> In the absence of bad faith or clear abuse of discretion, the effect of the constructive termination for convenience doctrine is to moot all breach claims and to limit recovery to costs which would have been allowed had the contracting officer actually invoked the [termination for convenience] clause. Thus ... we need not consider the merits of any claim for breach of contract here.

(citations omitted).

Hancock's arguments to the court of appeals and to this Court contradict the holding in Kalvar and thus misrepresent the law. Hancock pleads that because WMATA's alleged breach of contract consisted of a demand for an additional performance, as opposed to a lesser one, the type or circumstances of that particular breach of contract ought to constitute an exception to the constructive termination for convenience doctrine. Pet. 10. No case recognizes or suggests such an exception. From the point of view of the policy underlying the doctrine, the exception suggested by Hancock makes no sense. The Court of Claims stated in Nolan Brothers that the purpose of the doctrine of constructive termination for convenience is to disallow expectancy damages in the event of a government breach of contract. Why, then, should the government not be liable for expectancy damages if it breaches the contract by demanding a lesser performance but, if it breaches the same contract by demanding a greater performance, pay the contractor's lost profits? To fulfill the underlying policy, the

doctrine must, of course, be applied in both such instances and that is, in fact, the law.

The Kalvar Court noted no pertinent exception to the sweep of the doctrine of constructive termination for convenience. None exists. In this respect, Hancock misconstrues this Court's decision in United States v. Utah Construction & Mining Co., 384 U.S. 394 (1966), asserting that cardinal changes to a government contract are actionable in court. Pet. 5. Utah Construction addressed neither the doctrine of constructive termination for convenience nor the issue of cardinal changes to government contracts. It has no direct relevance to the dispute between these parties. In Utah Construction, this Court was asked to rule on the proper forum for resolution of disputes arising under a contract signed in 1955. Because the contract was completed, the termination for convenience doctrine was not at issue. Indeed, the decision does not mention whether the contract even contained such a clause. The claim of a "cardinal change" to the contract is nowhere addressed in the decision.

Moreover, even if one assumes, arguendo, the application of Utah Construction to the facts of this case, Hancock's cause does not prosper. In Utah Construction, the contractor, after completing the construction project, sought recovery of additional costs incurred, he argued, because of breaches of contract by the government. This Court allowed the contractor to pursue a breach of contract action for those claims because, inter alia, the types of breach alleged were not administratively redressable under the terms of the contract in question. See, 384 U.S., at 404-405. If, as

Hancock argues, delivery of software documentation was outside of the Changes clause in the parties' contract, Utah Construction would, at best, lend support to a breach claim for the extra costs incurred in providing that material. But Hancock's claim is not for the additional costs imposed by WMATA's alleged breach. Hancock claims that the entire contract was terminated. Pet. 4. Accepting that claim at face value, the Termination for Convenience Clause of the parties' contract specifies an administrative remedy for that termination. Because Hancock's claim is redressable under remedies provided in its contract, dismissal of its claim was entirely consistent with Utah Construction.

Additionally, Hancock misreads this Court's decision in College Point Boat Corp. v. United States, 267 U.S. 12 (1925), envisaging a conflict between that holding and the one rendered by the court of appeals it its case. Pet. 8. College Point Boat Corp. is the foundation upon which the doctrine of constructive termination for convenience rests. See, e.g., Reiner, Supra, at p. 443. It held that an unconditional right to cancel an agreement can be asserted as a defense against expectancy damages even if that right was not exercised at the time of breach. The Court stated that, "This continuing right of cancellation, which was asserted later, in court, operated to curtail the damages recoverable. It limited the value of the plaintiff's right to acquire performance, and hence the amount and character of the loss for which compensation must be made." College Point Boat Corp. v. United States, 267 U.S. 12,16 (1925). Decisions rendered by the Fourth Circuit in this case and by this Court in College Point Boat Corp. reach the same result for the same reasons. In both instances the contractor/

plaintiff's recovery for an alleged breach of contract by the government was held not to include expectancy damages because of the unconditional, contractual right of the government to cancel that contract. The two decisions are entirely congruent in logic and outcome.

The constructive termination for convenience doctrine, which was properly applied in this case, has been settled law for decades. Its intended effect, to limit a contractor's recovery to quantum meruit damages, has been consistently applied by courts, principally the Federal Circuit Court of Appeals, since the Reiner and Kalvar family of decisions in the 1960s. That doctrine also supports the important policy of having complex government contract disputes determined by the specialized administrative tribunals created for that purpose rather than by courts of general jurisdiction. The preference for administrative determination of such disputes is very strong. See, e.g., Moses H. Cone Memorial Hospital v. Mercury Construction Co., 460 U.S. 1, 24-25 (1983) and United States v. Anthony Grace & Sons Inc., 384 U.S. 424 (1966). In this case, Hancock had and continues to have the clear option of filing a claim before the contractually-specified administrative tribunal. It opted not to do so in order to pursue a greater allowable recovery, e.g., its expectancy damages, in the district court. Given the strength, age and comprehensive scope of the law limiting contractor's recoveries and the powerful judicial policies in preference of initial, administrative, determination of government contract disputes, Hancock's decision was bound to prove unwise. The Court of Appeals correctly applied the law concerning the doctrine of constructive termination for convenience.

B. Other Issues Proposed By Petitioner Should Not Be Reviewed.

Hancock complains that the Court of Appeals decided an issue that Hancock had posed in its Complaint and which had been briefed by both parties to the District Court and the Court of Appeals, e.g., whether WMATA's requirement for software documentation constituted a "cardinal change" to the parties' contract. Pet. 11-14. Hancock worries that, "The Court's ruling on this issue, therefor, effectively put [sic] Hancock out of court and likely out of business." Pet. 12.

The Court's discussion of the cardinal change issue does no such thing. The Fourth Circuit carefully refrained from expressing an opinion on the underlying merits of the parties' dispute as to whether the contract did, or did not, require Hancock to provide the software documentation: "In so doing, we express no view on the merits of the parties' underlying dispute." Hancock Electronics Corp. v. WMATA, 81 F. 3d 451,455 (4th Cir. 1996). Pet. App. 6a. Moreover, Hancock will have a full opportunity to defend its interests in any subsequent proceeding concerning termination of its contract. See, D. Moody & Co., Inc. v. United States, 5 Cl. Ct. 70 (1984).

The Court's discussion of the cardinal change issue addresses a threshold question of law which was extensively briefed by both parties. Hancock sought to avoid administrative resolution of its cause by arguing that WMATA's demands for software documentation constituted a " cardinal

change" to the contract. Pet. App. 5a. In government contract law, a " cardinal change " is a type of performance so profoundly different, in scope or in kind, from the original terms of the contract, that it is fairly characterized as beyond the scope of that original contract. See, e.g., Allied Materials & Equip. Co., v. United States, 569 F. 2d 562, 563-564 (Ct. Cl. 1978) (per curiam). Imposition of a "cardinal change" amounts to a breach of contract by the government. Id. Hancock had argued, unsuccessfully, that breach of a contract via a "cardinal change" was an exception to the Kalvar court's teaching that all breaches of contract were converted to terminations for convenience under applicable law.

Whether, on the facts alleged in the Complaint, Hancock had made out a case of "cardinal change" is a question of law, properly decided by motion. The Complaint, as the Fourth Circuit accurately noted, states that Hancock had completed its work on the braking system software, had brought the software documentation requested by WMATA to Washington and was ready to install its braking equipment, running on that software, on rail cars for qualification testing. App. 8. The Complaint thus affirms that all software documentation necessary to operation of the braking systems was complete and in hand. If Hancock had, as it claimed in the Complaint, composed all software necessary to operate the braking systems, then it necessarily had to have composed all levels of that software, e.g., from the english-like general instructions to the machine-readable binary programming. By way of analogy, if an author claims that her book is ready to publish, she is impliedly claiming that all component parts of the book, e.g., chapters,

paragraphs, sentences, words and characters, are complete as well. Thus, the Fourth Circuit's statement that, "[N]o one claims that Hancock had to perform extra work or develop new information to comply with WMATA's request," is both perfectly correct and apparent from the face of the Complaint. Pet. App. 6a.

Hancock did not, on the face of its Complaint, allege facts which, if true, would constitute a "cardinal change" type breach of its contract. The Fourth Circuit correctly noted that, as a matter of law, the additional performance alleged in Hancock's Complaint was not so profoundly different from the performance specified in the parties' contract as to amount, in law, to a "cardinal change" to that contract. Pet. App. 5a-6a.

CONCLUSION

The petition for writ of certiorari should be denied. The doctrine of constructive termination for convenience, properly applied in this instance by the Circuit Court, has been a settled feature of government contracts law for at least twenty years. Petitioner has presented no worthwhile reason to engraft a special exception to that doctrine.

Hancock's approach to its contract dispute was a studied, though very risky, attempt to overcome strong legal precedent in pursuit of greater damages. Hancock could have had its complaints adjudicated by the contractually-specified administrative tribunal. Had it done so, however, its potential recovery would have been limited to the quantum meruit damages specified in the contract's "Termination

for Convenience" clause. Instead, it chose to pursue a greater recovery of expectancy damages in the federal district court. That strategy transgressed at least two bedrock principles of government contracts law. Government contracts disputes should be heard, in the first instance, by the specialized administrative tribunals established for that purpose, not by the courts. Second, government liability in contract is limited, by contract, to the damages calculated under the termination for convenience clause. The decisions of the District Court and Court of Appeals are, accordingly, completely consistent with established law.

Respectfully submitted,

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